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FORTUNE

HOW STEVE JOBS LINKED UP WITH IBM

His new alliance outfoxed old pal Bill Gates—and is rocking the PC world

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FORTUNE

COVER AND ABOVE: Steve Jobs was photographed by Doug Menuez in one of Next Inc.'s new buildings in Redwood City, California.

"A funny thing has happened since we started working with IBM. We like them and they like us." PAGE 48

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The alliance that is rocking the computer industry started at publisher Kay Graham's 70th-birthday gala two years ago. Jobs met IBM CEO John Akers there and told him that IBM's strategy based on Microsoft software was all wrong. Akers countered with a question: "How would you like to help us?" *by Brenton R. Schlender*

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"He can rip you up in an awful nice way."

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"Now Larry [Tisch] is not that tough to figure out. I know that when I say 635, he'll say 650."

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EDITOR'S DESK

ED KASH

Schlender (with shoes) interviews Jobs at the Next picnic.

OUR COVER STORY, "How Steve Jobs Linked Up With IBM," is Keith Johnson's favorite kind of business tale. Says Johnson, who edited the piece: "Here you have very strong-willed, able people playing a high-stakes game of chess." The opponents: Jobs, founder of both Apple Computer and Next Inc., and Bill Gates, software king, Microsoft CEO, and billionaire. The prize: the support of IBM. Tracking the moves, analyzing the tactics, and explaining the importance of the outcome is associate editor Brent Schlender.

FORTUNE's man in San Francisco, Schlender spent three weeks at Next's factory and headquarters in Northern California interviewing Jobs and sitting in on marketing and strategy sessions. Says Schlender: "Jobs is more of a manager than I expected. He does use his veto power. But he is not condescending and his staff is not awed."

Maybe that's because Jobs knows how to throw a great party (above). Says Schlender: "Apple was a company of people in their 20s, with a lot of energy and very little need for sleep. Next is a company of 30-year-olds, who have kids and interests outside of work. Instead of having rock bands at its recent picnic, there were clowns."

To Schlender, Gates is an unusual interview: "Most people just answer the questions. Gates answers, then turns around and tells you why he thinks the question may be a little off line. It's helpful and not at all unpleasant. But like everything else at Microsoft, it's a little intense." Marveling at how Jobs ended up with Big Blue after all the nasty anti-IBM ads he ran at Apple, Schlender concludes, "Corporate strategy is as much a matter of politics as technology."

Another technology expert, associate editor Stuart Gannes, has just completed a year at Stanford University, where he was a John S. Knight journalism fellow. He chose to write about BellSouth, the biggest of the Baby Bells, partly because of its success in the fast-growing cellular phone business. Gannes finished his piece at 1 A.M. on Monday. At 8 A.M. a company press officer called him at home: BellSouth had just agreed on a $10 billion deal with Lin Broadcasting to merge all their cellular operations. Says Gannes: "She said Chairman John Clendenin wanted me to be the first to know."

We want our readers to be the first to know the inside story on BellSouth, as well as what's going on at Next, Microsoft, and IBM.

Ann M. Morrison
ASSISTANT MANAGING EDITOR

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Company	Revenues (latest four quarters, in millions)	Net income (in millions)	Stock price range (past 12 months)	Recent price / P/E multiple*
Browning-Ferris	$2,403	$254	$25.00–$39.375	$37.63 22
Laidlaw Transportation (Class B shares)	$1,349	$177	$12.625–$17.125	$16.75 19
Groundwater Technology	$102	$10	$20.50–$29.50	$24.75 20
Ionics	$91	$3	$14.625–$24.375	$22.75 30
Trion	$53	$3	$5.125–$10.00	$8.13 16
Canonie Environmental	$44	$4	$16.75–$27.75	$16.75 22

*Based on earnings in the latest four quarters, exclusive of nonrecurring items.

NOT DOWN IN THE DUMPS

Analysts are intrigued by these companies that clean up the environment and dispose of waste. Ionics makes purifiers (left) that supply Buckeye, Arizona, with 900,000 gallons of water a day.

3% for the year, barely enough to make up for a 1.25% sales load and a 0.6% annual fee.

Shearson Lehman's no-load **SLH Global Currency** fund, which has been around since last November, has done far better. Structured as a limited partnership, it is able to trade more aggressively in the short term because limited partnerships do not operate under the same trading restrictions as traditional mutual funds. The approach appears to be paying off: So far in 1989, the fund is up 12%. Shearson, which also offers four single-currency funds, requires a minimum investment of $2,500. – **Ellen Schultz**

ROSES AMONG THE ENVIRONMENTAL ASHES

■ You can't get away from the environment. It's everywhere, and so is talk about buying into companies that handle solid waste, dirty water, and polluted air. For that very reason, good buys are hard to find. Since President Bush announced his new clean air bill, for example, stocks of companies that build scrubbers or supply the lime used in them have become as hot as the exhaust gases they cleanse.

For conservative, conservationist buyers, mutual funds that specialize in environmental stocks may be the best path to the greensward. Boston's Fidelity Investments started up its **Select Environmental Services Portfolio** last June, and Freedom Capital in the same city recently launched its **Freedom Environmental Fund**. But more intrepid souls may choose to undertake their own quest for the occasional rose among the ash heaps.

The resurgence of public interest in the environment has helped make stock market stars out of solid-waste disposers **Waste Management** of Oak Brook, Illinois, and Houston's **Browning-Ferris**. Both are trading at over 20 times earnings, well above the market multiple of 14, though most market watchers feel the stocks are fairly priced as industry leaders in a recession-proof business. There will be garbage to dump, no matter what.

Lawrence Greenberg, who runs Fidelity's environmental fund, still thinks these stocks are good buys but sees more upside in Browning-Ferris. He also likes the cheaper **Laidlaw Transportation**, based in Burlington, Ontario, whose stock trades over the counter. Well-known as the operator of a 20,000-strong fleet of school buses, Laidlaw is also the third-largest handler of solid and hazardous waste in North America. **Chemical Waste Management**, 81.1% owned by Waste Management, is the big, expensive, pure play in toxic waste cleanup but has a nosebleed P/E of 30. Beth Heming of Chicago Corp. thinks little **Canonie Environmental Services**, an over-the-counter outfit in Porter, Indiana, that treats hazardous dumps, could be just as profitable to the investor in the long run.

Companies that deal with tainted water and air are tougher calls. Drexel Burnham's Leone Young notes that "most of these little companies weren't publicly traded during the last recession." Because they are generally growth stocks, P/E multiples are very high and short-term gains unlikely. Says Richard Eastman of Blunt Ellis & Loewi: "This group is not for conservative investors."

But if you are ready to hold on for two or three years, Eastman thinks **Groundwater Technology**, a small over-the-counter company in Norwood, Massachusetts, that treats what comes out of wells, could pay off handsomely. Despite a P/E of 30, Greenberg favors **Ionics**, a manufacturer of water-purification equipment located—appropriately—in Watertown, Massachusetts. Ionics has begun selling purified drinking water to businesses under the brand name Aqua Cool. Says Greenberg: "It has a very good chance of becoming the first national bottled-water company."

David Beckwith, who runs Freedom Capital's environmental fund, thinks there are still buys in companies supplying lime for scrubbers. But even aggressive Wall Streeters find their stocks untouchably high now. When it comes to dirty air, they say, **Trion**, a Sanford, North Carolina, maker of air filters for all sorts of places from living rooms to Trident submarines, currently offers the best hope of cleaning up from cleaning up. – **Terence P. Paré**

BELLSOUTH IS ON A RINGING STREAK

Not only is this AT&T offspring the biggest and most technologically advanced, its new deal with Lin Broadcasting could make it tops in cellular phones. ■ *by Stuart Gannes*

HOW GOOD is the phone business? Ask BellSouth CEO John L. Clendenin. Better yet, send him a fax, beep him, or call him on his car phone. If he's not there, leave him a voice message. His low-key answer, in a pleasing Texas drawl, will be something like "The phone business is a pretty healthy place to be."

Actually it's red hot. Local and long-distance telephone revenues will top $141.5 billion this year, according to Columbia University's Center for Telecommunications and Information Studies, and the business is now bigger than computers or aerospace. Thanks to a stream of innovative services—electronic data networks, information services, and discount long-distance packages as well as cellular car phones and fax—total telephone usage is growing almost three times as fast as the population. Says Greg Sawers, a security analyst at the New York City investment firm of Sanford C. Bernstein & Co.: "Telecommunications will be the best business of the next decade, period."

Nobody knows this better than Clendenin, 55, a career telephone executive who heads the largest and technologically most advanced local telephone network in the U.S. Nearly six years after BellSouth and six other regional phone companies emerged from the breakup of American Telephone & Telegraph, the Baby Bells are chafing at regulatory constraints they consider out of date in their fast-evolving business. Says Clendenin: "The very idea of what constitutes information is changing. If it can be digitized, it can be transmitted. That includes photographs, movies, symphonies, books, financial or engineering data, and of course voices. We can make the telephone line your entry gate to the information age."

REPORTER ASSOCIATES *Karen Nickel, Darienne L. Dennis, and Gabrielle Solomon*

CEO Clendenin: "Have you Ramboed yet?"

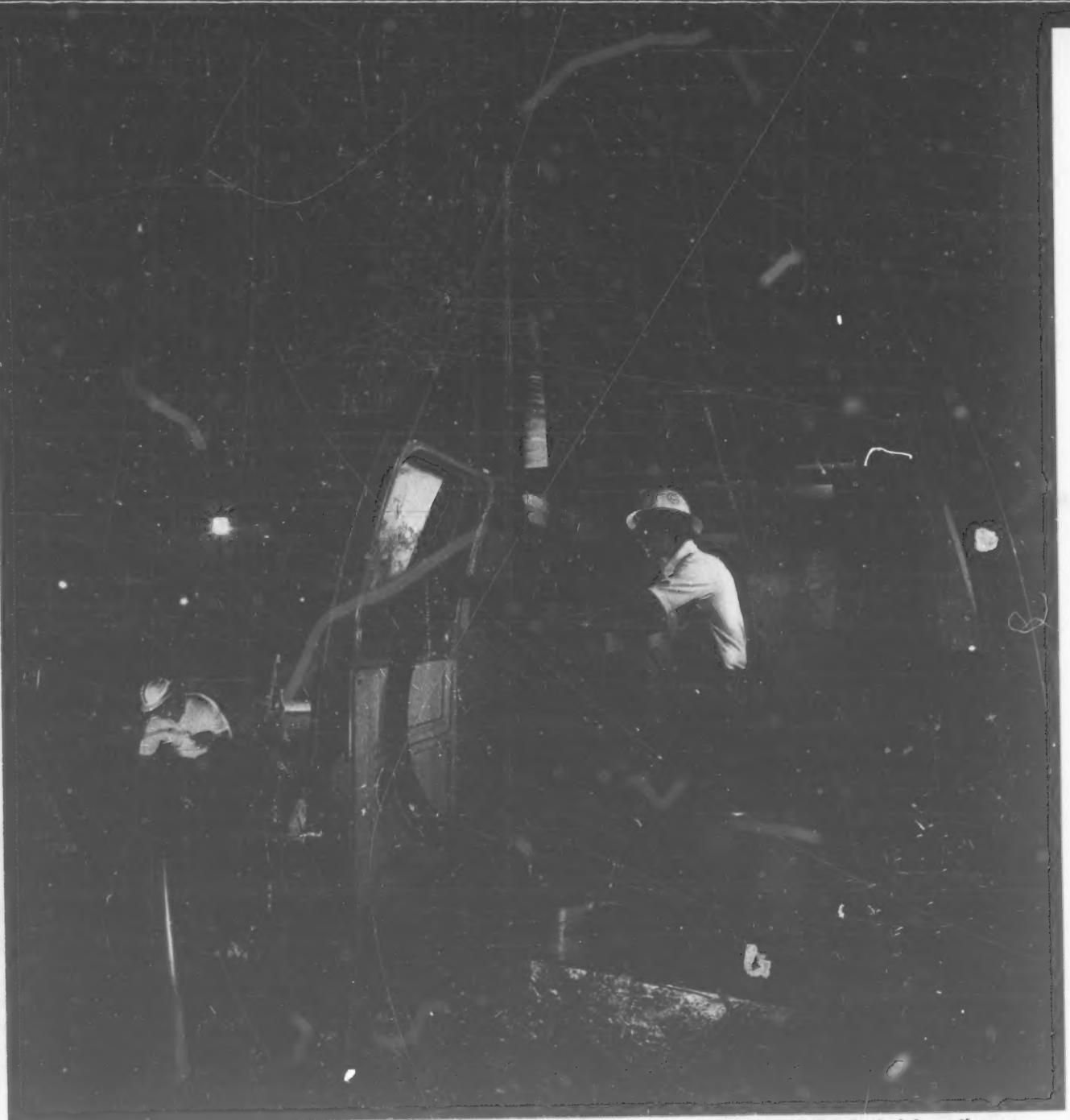
BellSouth is already a powerhouse in the booming—and loosely regulated—cellular telephone industry. Last spring's $710 million acquisition of the remaining shares of Mobile Communications Corp. of America made BellSouth the third-largest cellular company in the U.S., with some 345,000 subscribers in such cities as Los Angeles, Atlanta, Houston, and Miami. Now Clendenin has reached an agreement to spin off and merge BellSouth's cellular operations with those of Lin Broadcasting of New York City, the No. 7 carrier with 295,000 subscribers in such choice markets as New York, Dallas, and Philadelphia. If the deal goes through, the combined company, half owned by BellSouth, with an option to buy 100% later, will pass McCaw Cellular Communications as the largest in the business. Sawers estimates that cellular and paging services could contribute about $500 million to BellSouth's profits by 1993.

Meanwhile, BellSouth and its siblings are dancing in a shower of cash from their regional telephone monopolies. Six years ago AT&T appeared to be hanging on to the glamour businesses, such as long distance and computers, while casting off the dregs. The regional companies, to use an industry acronym, inherited POTS, or plain old telephone service.

But as a group the Baby Bells earned $8.9 billion in 1988, up 6.5% over the previous year. Since January the septuplets' stocks have shot up 35% on average, more than the market's 24% and faster than earnings growth alone (see chart) would seem to justify. Many investors are attracted by the surging cellular telephone business, whose value may be inadequately reflected in the regionals' stock prices. But of equal importance to Wall Street analysts is the move by many states—eight at last count—toward incentive-based regulation of the core phone service.

The traditional regulatory approach sets the rate of return the telephone company may earn, usually expressed as a percentage of capital or shareholders' equity, but provides no real spur to boost efficiency. By letting the companies keep a portion of any profits above their allowed rate of return, telephone folks say, the new approach could prompt a wave of streamlining and put earnings on a steeper growth curve. Salomon Brothers analyst Lap Lee considers the new regulatory trend a major reason to buy Baby Bell stocks. "This is like the New York real estate market in the 1970s," he says. "The value was there but nobody saw it."

PHOTOGRAPHS BY ROB KINMONTH



In Coral Gables, Florida, a Southern Bell worker buries fiber-optic cable, the new backbone of what Clendenin calls the information age.

In today's telephone industry, BellSouth stands out like a lit-up switchboard:

■ With 1988 revenues of $13.6 billion, it is the biggest of the regionals. It makes the most profits ($1.7 billion last year) and sits on the most assets ($28.5 billion).

■ Shunning ill-considered diversification efforts like computer retailing and real estate development projects, which many of its siblings have since unloaded, BellSouth stuck to its knitting. Its biggest investments outside its basic service, cellular systems and Yellow Pages, are phone related. Clendenin's 1986 purchase of Yellow Pages marketer L.M. Berry makes BellSouth a world leader in the highly profitable directory publishing business. By 1991, promises Clendenin, 25% of BellSouth's revenues will come from such unregulated activities.

■ BellSouth was one of the first Baby Bells to move abroad, where it is a big winner in the race for cellular business. In Argentina a BellSouth-led consortium recently beat out two other regionals for a $220 million contract to build a mobile phone system. And it is a partner in cellular and paging operations in France, Britain, and Australia.

■ The company's basic network is the most technologically advanced in the U.S. Some 95.3% of its switching offices now operate with efficient electronic controls, and more than 97.8% of its major trunk lines use high-capacity fiber-optic cable—tops among the Baby Bells. BellSouth is the first U.S. telephone company to bring optical fiber right to customers' homes.

■ Even BellSouth's labor relations are enviable. Last summer it was the first regional to sign a contract with the Communications Workers of America. Negotiations at the other six Bells bogged down when management tried to shift more of its rising health

care costs to workers, and three companies took long strikes. BellSouth, with more success than its sisters in restraining health costs, didn't have to confront the unions. ■ For these and other reasons, BellSouth is the most admired utility. In FORTUNE's 1989 survey of corporate reputations, it was ranked above its telephone peers by a group of senior executives, outside directors, and financial analysts. Says Robert B. Morris III, a security analyst at Goldman Sachs: "BellSouth does almost everything right. It's been a consistent story. They never stumble."

From birth, to be sure, BellSouth had some key advantages. Booming Southeastern states like Florida, Georgia, and North Carolina are where any company dreams of operating. The company also controls the phone systems in Alabama, Kentucky, Louisiana, Mississippi, South Carolina, and Tennessee. With its total number of telephone lines increasing by more than 600,000 per year, BellSouth can install efficient new switches and fiber-optic lines without having to tear out existing equipment before it is fully depreciated. Few other regionals, save Pacific Telesis (see box), have that luxury.

"We were blessed, I can't deny that," says Clendenin. "But the blessing only gets you up to bat. Whether you get a hit or not is up to you." The intense and restless CEO, who sometimes arrives at BellSouth's green-glass midtown Atlanta headquarters by 4 A.M. but doesn't take time for breakfast, wants the company to grow at a rate that exceeds even the heady population trends of the Southeast. That means more innovation and continued high capital investments. "It would be easy to make a quarter or a year look great financially," Clendenin explains. "All we have to do is stop spending. But you don't grow a business by circling the wagons."

Clendenin's associates perceive a mix of Southern gentility and toughness in their boss. Says one: "He can rip you up in an awful nice way."

The son of a mining company geologist, Clendenin grew up in El Paso, Texas. After starting at Swarthmore College in the same class as Massachusetts Governor Michael Dukakis, he transferred to Northwestern University to take journalism courses. Says Clendenin: "All my brothers and sisters were science majors. At the dinner table they'd be talking about physics and geology, while I was thinking about social justice." He married after his junior year and worked nights for a manufacturer of dry-cleaning equipment. His wife, Ann, was a secretary for an insurance company. While waiting for a spot in Air Force flight school, he joined Illinois Bell as a trainee.

In 1955, when the cold war was pretty warm, Clendenin was ordered to the Strategic Air Command. Stationed in Guam as the pilot of a B-47 equipped to carry nuclear bombs, he had to practice low-altitude bombing runs. "The idea," he recalls with a trace of nostalgia, "was to come in under 1,000 feet, below the enemy's radar, then pull up and turn back just as you released the bomb." If the bombs had been live, Clendenin says, "we knew we would never get away fast enough, but we would give it the old college try."

William McCoy heads the cellular and Yellow Pages operations.

Back home in 1959, he rejoined the telephone company and moved quickly through the ranks—to Pacific Northwest Bell in Seattle, an AT&T staff position in New Jersey, and finally to Atlanta in 1981 as president of Southern Bell. The following year, he began working on the post-divestiture business plan for BellSouth. He was CEO from day one.

Everyone who worked for Ma Bell vividly recalls January 1, 1984, the day of the Big Bang. Richard J. Sharp, now vice president of human resources at BellSouth, picked up his home phone to check if there was still a dial tone. Clendenin says he had mixed emotions. "We had a culture that we knew had to change, yet it was also our heritage. There were good and logical reasons behind the old Bell system. But they produced a narrowness in operations that frustrated people."

Clendenin devotes hours to his BellSouth homework. He reads more than 30 magazines a week, from *Time* and *Harvard Business Review* to industry journals like *Telephony*, and talks to "technology gurus and other people I can drain for information." He has frequent "soak times," briefings with Duane Ackerman and William McCoy, BellSouth's two vice chairmen. "Then I send out a lot of sloppily written questions about what's going on here." Clendenin's associates perceive a mix of Southern gentility and mental toughness in their boss. Says vice president Sharp: "He can rip you up in an awful nice way."

FOLLOWING a "loose-tight" management approach, Clendenin delegates authority to his officers. They have considerable latitude, he says, in meeting a set of specific quarterly objectives and yearly commitments after they have been approved at the top. Still, corporate strategy emanates from a policy council that Clendenin heads. Since he also emphasizes the importance of the team approach, arguments are rare.

To stir BellSouth's managers to take more initiative, Clendenin hired two consulting firms to conduct a series of wilderness retreats. Nicknamed Rambo school by company executives, they are held in the Georgia backwoods or the Florida Keys. During the day managers learn lessons in communications and cooperation. Examples: snagging a flotilla of loose barrels floating down the river or agreeing upon a set of directives on how to build a raft. Judy North, a marketing vice president at South-

In L.A., America's most cellularized city, BellSouth battles for customers with PacTel.

ern Bell, was part of a team that had to follow another group's instructions. "We built the raft, but it wouldn't float. Then we were underwater. We got wet and dirty an awful lot," she says. At night the executive campers watch the movie *The Bridge on the River Kwai*, then go to sleep in tents. Back in Atlanta, they ask each other, "Have you Ramboed yet?"

The Rambo school highlights the difference between the old paternalism of AT&T and Clendenin's hand-over-the-ball approach. Many telephone veterans are thriving in the new atmosphere. Before divestiture, recalls Harvey R. Holding, BellSouth's chief financial officer, "AT&T had done all our tax planning, it held our equity, it helped us with our debenture issues. All of a sudden we had to do these things ourselves."

Like all the regionals, BellSouth is running and selling basic phone service far better than it ever did under AT&T. Marketing vice president Don L. Strohmeyer revved up his operation from scratch. "Prior to divestiture, the Bell System was not in the marketing game," he says. "We had about a dozen products, like custom-calling and Touch-Tone features. But there was no pricing flexibility. We couldn't promote a new feature by waiving the installation charge."

Strohmeyer hired market researchers to develop profiles of large BellSouth customers, including banks, health care institutions, government agencies, and military bases. Then special teams were set up for the top 200 customers—including Coca-Cola, Federal Express, and Delta Air Lines—which account for about 30% of all revenues from major business customers. The payoff: BellSouth is hanging on to most of these big phone users, who unlike homeowners are no longer captives of the local monopoly. With roof transmitters and other devices, they can bypass it and beam calls directly to AT&T, MCI, and other long-distance carriers.

THE RESIDENTIAL market, under Strohmeyer's scrutiny, was divided into groups with similar incomes and phone-use patterns. One segment, for example, is called Briefcase High-Techers. "People in this category indicate the phone is critical," Strohmeyer explains. "They make business calls at home. They bring work home and are interested in knowing whose calls they have missed. They make few local calls. Almost all of them have personal computers and answering machines, and 20% have second lines." By contrast, Middle-of-the-Road Kid-poolers "are middle income, middle education." They have no interest in missed calls and make minimal use of long distance. Other groups include Single Gadgeters With Teens, unmarried low-income folks with high-tech phones and cable television, and Grey Home Entertainment, retirees with VCRs, cable TV, and phones especially designed for those with hearing and other problems.

The Baby Bells have whacked away at costs by trimming staffs and paring debt. Now they are investing heavily in new technologies. BellSouth will spend some $3 billion this year for new switching and transmission systems to upgrade its phone network. By January 1, promises Richard Snelling, head of network operations for Southern Bell, every switching center in his territory will be electronic. That's good news for business customers, which are demanding more advanced data-handling capabilities. The new centers are more reliable *and* less expensive to operate. Says Snelling: "The faster you get the old stuff out, the more competitive you can be."

Small wonder that switch manufacturers like AT&T, Northern Telecom, and Fujitsu wait in line to persuade BellSouth to try out their latest whiz-bang equipment. Northern, for example, is teaming up with BellSouth and an independent cable television operator to provide an underground fiber-optic cable system for the planned community of Heathrow, Florida, near Orlando. A single optical cable, available to both offices and residences, will provide normal telephone service plus 36 cable television channels, pay-per-view movies, security and energy management information, and access to electronic data. While it does not pay to rip out existing copper cables delivering phone and TV service to homes, BellSouth says the outlook for fiber optics is improving all the time. By next year, it says, it will make economic sense to install optical lines delivering voice signals—but not video—to new housing tracts.

On its existing telephone networks in Atlanta and West Palm Beach, Florida, BellSouth is testing nearly a dozen convenience features in a bid to wring more use from the network and raise efficiency. Customers with PCs and modems, for example, can call up an "information gateway" that lets them tap into databases, check stock quotes, or make airline reservations. Drivers with cellular phones can dial *123 to hear traffic reports for the areas they are passing through, or a personal code to listen to their voice

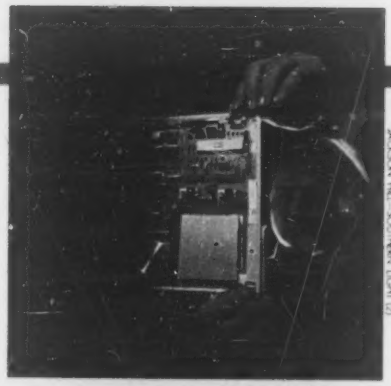
mail. An audio information service allows parents with children in one of Atlanta's schools to call the school on Touch-Tone phones, then punch numbers to hear the day's class assignments, the lunch menu, or a message from the school principal. The feature, which BellSouth plans to expand to other schools, has been a hit.

WHETHER BellSouth and the other regionals can reap the full rewards of such innovation is still in doubt. To a great extent, the regionals' future earnings depend on whether they can persuade state utility commissions to change the way the industry is regulated. For decades these commissions have allowed a fairly fixed return, recently in the range of 12% to 15%.

Security analyst Sawers estimates that in 1988 the regional Bells collectively earned some $500 million above their allowed rates of return, which they had to surrender to customers in the form of rate reductions. He says, "In the absence of either a shift away from strict rate base regulation or a sharp increase in capital expenditures, earnings from the regulated telephone business have reached a plateau."

If the Baby Bells had their druthers, they would operate under price ceilings negotiated with the government, as British Telecom does. Industry observers doubt that state commissions will go for this idea any time soon. But BellSouth and most other regionals are beginning to win acceptance for a somewhat less ambitious approach called "incentive regulation plans." Under these schemes the phone company gets to keep a percentage of the profits, usually 50%, above its authorized rate of return.

As a quid pro quo, the commissions demand rate freezes and reductions, called "buy-ins." That happened when three of BellSouth's states, Florida, Kentucky, and Alabama, recently okayed incentive-based regulation. Sawers estimates that buy-ins and subsequent rate cuts in these states will cost BellSouth $690 million in reduced revenues over several years. But beginning in 1990, he figures, operating income growth should start to accelerate unless BellSouth negotiates further buy-ins in other states it serves.



New Orleans has optical terminals, but operators still assist on some calls.

State regulatory reform is not the only hurdle between Clendenin and the golden age of information. The agreement that broke up AT&T bars the regional Bells from making telephone equipment or offering long-distance service outside sharply circumscribed areas. They can transmit other people's computer data but not originate it. Other federal legislation prohibits them from operating cable television franchises in their own territories, though they can and do own them elsewhere. But the Baby Bells also got a few key favors at birth, most importantly the emerging industry of cellular phones.

Nationwide cellular revenues are now about to pass the $3-billion-a-year mark. Revenues and operating income are rising about 50% annually. Advances in technology will soon make it possible for cellular companies to expand capacity at negligible cost. To top off the bonanza, the business is barely regulated. The Federal Communications Commission merely requires that two players operate in each metropolitan area to ensure competition. The local telephone company automatically gets one cellular franchise and the other sometimes winds up in the hands of a phone company based elsewhere.

Each cellular market has taken on the atmosphere of a gold rush town. In Atlanta, where BellSouth competes against PacTel, both rivals send salesmen out on "windshield chases." Explains Earle Mauldin, head of BellSouth's cellular business: "We go at it on the street every day. We look for cellular antennas on cars and try to get customers to switch. We offer people free business cards if they put their cellular phone number on them. That way, we figure, they'll be less likely to change." At present, say Wall Street analysts, cellular franchises are worth anywhere from $150 to $200 per potential customer.

With consolidation the phone companies have grabbed up most of the business. While they are still trying to buy systems, there is little left to be sold. Of the remaining independents, Lin Broadcasting—which owns parts of cellular franchises in New York, Los Angeles, Philadelphia, and Dallas—is the belle of the ball. While some other operators are beginning to report profits, Lin earned $82 million in its latest year on revenues of $226 million. Says analyst Morris of Goldman Sachs: "There is only one Lin."

continued

PLENTY OF BOUNCE IN THESE BABIES

COMPANY	REVENUES latest four quarters in billions	ANNUAL GROWTH RATES four years through 1988 REVENUES	PROFITS	11/21/83-9/1/89 TOTAL RETURN TO INVESTORS*	RECENT STOCK PRICE P/E multiple
BellSouth	$13.9	9.3%	7.3%	25.4%	$52.00 14
Nynex	$13.0	7.4%	7.5%	24.7%	$79.00 13
Bell Atlantic	$11.0	7.7%	7.9%	26.9%	$96.00 14
Ameritech	$10.0	4.4%	5.7%	27.1%	$60.13 13
U.S. West	$9.7	6.1%	6.3%	23.8%	$69.00 12
Pacific Telesis	$9.6	4.9%	9.4%	31.2%	$44.88 16
Southwestern Bell	$8.6	4.1%	4.7%	25.7%	$53.63 14

*Source: Sanford C. Bernstein & Co.

Last summer Lin's management rejected an unsolicited $5.85 billion buyout offer from McCaw Cellular Communications of Kirkland, Washington, currently No. 1 in market share. Lin demanded at least $6.22 billion. Security analysts have generally ruled out a higher cash offer from BellSouth or any other regional because it would dilute earnings. BellSouth's bombshell mid-September agreement to create a joint venture with Lin gets around this problem.

The phone company would not part with a penny of cash, says Clendenin. "It uses a currency which is not dollars but the value of our own cellular operations." Sawers agrees: "The company is buying expensive assets but paying for them with its own expensive assets. It's a beautifully structured deal." But Lin is not in the bag. McCaw might come back with a higher counteroffer. Says Clendenin: "We'll cross that bridge when we come to it."

Whatever happens on that front, BellSouth plans to keep the new products coming to serve the information age. Engineers at the company's labs in and around Atlanta are working on sophisticated ways to block nuisance phone calls, for example, and on new Yellow Pages features with fax options. A prototype view-on-demand TV system being tested in five cities allows customers to order by phone, say, a stereo concert video from a tape library. With optical cable, Clendenin says, it would be no trick to transmit such a program in the new high-definition TV under development. People are just starting to realize, he adds, what technology can do to keep the phone lines humming. Five years ago who would have expected such talk from the head of a plain old telephone system? F

PACIFIC TELESIS: "NOON ON A SUNNY DAY"

BellSouth may be the biggest and most impressive of the Baby Bells, but Pacific Telesis Group has scored an underdog's triumph. Weighed down by a tough regulatory environment and heavy debt at birth, it boosted profits 43% between 1984 and 1988, to $1.2 billion, on a 21% rise in revenues. PacTel's stockholders have reaped the biggest cumulative total return among the AT&T spinoffs. The stock price has jumped nearly 50% just this year, to around $45. Says security analyst Robert B. Morris III of Goldman Sachs: "At PacTel, it's noon on a sunny day."

PacTel does have a few things going for it, including Chairman Sam Ginn, 52. Whether he is trying to sink a putt, return a volley, or close a customer account, he hates to lose. "Competitive is not the word for Sam," says diamond wholesaler Ronald Goodstein, his tennis doubles partner and good friend. "He is *super*competitive. He is always in the game, every point."

Some 98% of the company's phone customers are in California, whose thriving economy and seemingly unstoppable population growth have led to an insatiable demand for phones and fax machines. California's public utility commission, tilted toward consumers for years, has softened following Governor George Deukmejian's appointment of five pro-business regulators.

Late in September the commission was scheduled to vote on a proposal with far-reaching ramifications: an incentive regulation plan that would allow the state's two large phone companies—GTE and PacTel subsidiary Pacific Bell—to keep all earnings up to a benchmark 12.75% rate of return on capital and to split profits above that point fifty-fifty with consumers. Overnight, PacTel would become the regional Bell company with the largest share of its phone business covered by incentive regulation.

PacTel management has moved aggressively to exploit its California advantage. Former chairman Donald Guinn, who took early retirement at age 55 in 1988, jettisoned more than $1 billion in debt, along with 28,000 employees, and began modernizing the phone network. Guinn put all employees, from mail clerks up, on an incentive pay plan and took PacTel into the uncharted seas of unregulated business.

Throughout the turmoil Ginn, who spent 23 years at AT&T before joining Pacific Telephone in 1978, proved himself a capable first mate. He piloted the company's diversification into paging systems, computer retailing—a business he quickly exited—and cellular phones. The latter turned out to be, in Ginn's words, "another Alexander Graham Bell opportunity."

Boss Ginn at San Francisco headquarters

PacTel's cellular operation, which earned $13.5 million on revenues of $111.5 million in the second quarter of 1989, is one of the most profitable in the country. The company boasts 316,000 subscribers and franchises in most major markets, including Los Angeles, Detroit, and Atlanta. Revenues and operating income are growing faster than 50% a year. If sold, PacTel estimates, the business would fetch about $6 billion.

Ginn faces a number of uncertainties, above all competition. Noting that since divestiture AT&T's long-distance market share has plunged from 85% to 67%, contributing to drastic work force cuts, a PacTel engineer paused over his tuna salad sandwich at a recent brown-bag lunch in Pasadena, California, to ask Ginn the question on every employee's mind: What's going to happen to *us*?

The chairman told him that the company will do whatever it takes to keep on streamlining operations. "It's just a matter of time before every segment of our business will be competitive," Ginn said in his typical, tell-it-like-it-is fashion. "We can't stop that. So we've just got to hitch up our pants and go after that marketplace better than anyone else." Exactly what you'd expect from a hard-charging tennis player. – **Nancy J. Perry**

LOOK WHO NEEDS OUTPLACEMENT

It's shakeout time in the booming business that helps victims of corporate downsizing. Turmoil in the industry that guilt built means cutting rates—and people. ■ *by Jeremy Main*

WHEN THE GRIM reaper of corporate restructuring comes calling, as he has for hundreds of thousands of executives in the 1980s, he may bring you a new acquaintance. Chances are that after your boss has given you the bad news he will lead you next door to meet a pleasant, soothing fellow. Say hello to your outplacement counselor, the undertaker of American corporate jobs.

Most people, including some in the outplacement business, aren't entirely sure what these well-meaning morticians are supposed to do. But they rarely fail to generate heated reaction. The pushed-out who feel the counseling helped them find jobs can be ecstatic about the value of outplacement services. Those not so fortunate tend to use expletives. One thing is certain: The corporations that pay for outplacement generally love it; having the counselors around makes firing people easier.

The services' increasing popularity has produced a ten-year spurt of extraordinary growth. Revenues have jumped from $35 million in 1980 to $350 million in 1988, by the estimate of Kennedy Publications of Fitzwilliam, New Hampshire, which compiles data on the subject. Growth probably will continue.

But right now the industry that guilt built looks as if it may need help from, well, an outplacement agency. The business is in turmoil. In the classic manner, all that growth has attracted too many competitors, and now it's shakeout time. Firms are merging and folding, cutting rates sharply, and their leaders are hurling harsh verbal shafts at each other. "On one hand, the industry is growing very rapidly," summarizes a new survey by ConsultAmerica, a Maynard, Massachusetts, consulting company. "On the other, consulting firms are facing higher costs of success and survival."

REPORTER ASSOCIATE *Ret Autry*

Hunting for new jobs, two out-of-work executives make calls and research potential employers from the New York offices of Right Associates, the No. 2 outplacement firm.

PHOTOGRAPHS BY JOHN S. ABBOTT

While the industry appears altruistic, outplacement is a very competitive business."

All that competition is spurring firms to improve service. But just what *is* an outplacement company supposed to do? After defusing the ousted executive's anger (and with a little luck, reducing the danger of a lawsuit), the outplacement counselor offers a range of services in ensuing months: psychological treatment for trauma (if necessary), help with writing résumés, videotaped rehearsals for job interviews, and office, secretarial, and research facilities. The outplacement firm will specify carefully that it will not find the client a job; it will teach him how to find one. But as the business matures and clients become more demanding, outplacement firms are going far beyond these basics. Top ex-executives may be provided with personal help for a year or more in discrete and luxurious quarters, with extras such as financial planning, early retirement preparation, counseling for what are called trailing spouses (mates whose lives are affected by the firing), and even health clubs.

That said, outplacement is still an industry trying to find and define itself, mixing opportunism with altruism. Says Louis Masterson, who runs his own firm in Cleveland: "Outplacement has become a haven for people whose qualifications are suspect, people with a marketing focus. There are no barriers to entry." Masterson regrets there is no training or professional certification. "The executive search business has kept its integrity, but outplacement has not."

Robert Chapman, a partner in King Chapman Broussard & Gallagher of Houston, puts the industry's dilemma this way: "Is outplacement going to be a professional

practice providing what's best individually for each client? Or is it going to be a business like temporary employment agencies, putting everyone through the same program?"

Outplacement executives and their clients question whether out-of-work executives need expensive psychological counseling and comfortable offices with secretarial help and phone services. Those nice offices may be no more than executive day-care centers that keep the client from really looking for a job.

Most of the industry regards James Challenger of the fourth-largest firm, Challenger Gray & Christmas of Chicago, as their black sheep, and he regards the others with undisguised disdain. Rivals say his network of 16 offices outside Chicago consists mostly of sales operations that funnel clients into the city for some quick, expensive counseling. He emphasizes his success in getting ousted managers new jobs fast, compared with the "appalling" record of "people who do nothing" for their clients.

FOR ALL the sniping, outplacement has established its place in business. Despite some bad experiences, individual and corporate clients generally appear to appreciate the help. In a survey of 250 displaced executives conducted in 1987 by FORTUNE and E.A. Butler Associates, a New York executive search firm, three-quarters of the executives who had used outplacement help said they found it useful. AT&T keeps no fewer than 19 outplacement firms on retainer, and many other companies have two or three on tap for departing managers. William Henderson, a senior vice president at SmithKline Beecham, which went through a 1,000-worker cutback last year, says the Manchester firm in Philadelphia "helped enormously because people didn't go away mad."

But even lots of enthusiastic corporate clients cannot support all the outplacement firms out there. One result is a rate war. Says the human relations vice president of a FORTUNE 500 company: "There's tremendous flexibility on prices. Firms are offering any number of incentives." Normally outplacement outfits charge 15% of the annual gross pay of an outgoing executive. But today the fee is likely to be 15% of base pay only, and that can be discounted by several points for volume. A second-tier service known as group practice, for blue-collar and clerical workers, is even more competitive. The two- and three-day seminars that previously cost $1,500 a day for a dozen or so employees may now cost $1,200 or less.

"Very intense," says Drake Beam Morin President Jim Cabrera of the competition.

Outplacement companies would like you to believe it's the other fellows who are recklessly cutting fees. Drake Beam Morin (DBM) of New York, the biggest by far of the outplacement firms, "is the leader in price cutting," says Stanley Tilton, president of Right Associates of Philadelphia, the No. 2. "I'm flabbergasted. They can't be profitable. They're going after market share. They won't drive us out of business, but they will the boutiques." James Cabrera, DBM's president, agrees that price competition is "very intense" and that DBM is gaining market share, but denies excessive discounting on his firm's part.

ALL THIS TALK of money is painful to an industry that likes to see itself in an aura of altruism. Striking a typical stance, Tilton says, "If you're in it for the money, you'll go bust. If you're in it for service, you'll have a business." The industry can legitimately claim some goodhearts. Two of the ten biggest firms, Mainstream Access and Manchester, were founded by ex-priests who put their fatherly skills to work for profit in a secular field.

With backgrounds more often in psychology than economics, many outplacement executives are not the world's sharpest businessmen. Yet they have to juggle marketing, expensive help (qualified counselors earn $60,000 to $80,000 a year), prime real estate, and narrow margins. So the squeeze between high costs and discounted fees is starting to hurt. Hay Group Inc. of Philadelphia, one of the leading personnel consulting firms in the U.S., is closing its ten-year-old outplacement operation. Says David Hamrick, the division's head: "It just didn't look attractive compared to other industries we're in."

Mainstream Access, a New York firm founded in 1969 by Richard Pilder, a former priest, and his brother William, a former seminarian, recently filed for Chapter 11 protection to reorganize. Mainstream drew its strength from handling large group dismissals in the steel and auto industries when those businesses were cutting back massively, and later expanded into serving high-level executives individually. But this expansion meant renting expensive real estate in places like New York's Rockefeller Center and Pittsburgh's Mellon Bank Center. Then came the discounting. The Chapter 11

TOPS IN OUTPLACEMENT

	1988 OUTPLACEMENT REVENUE (in millions)	NUMBER OF OFFICES	NUMBER OF CONSULTANTS
Drake Beam Morin New York City	$75.0	77	500
Right Associates Philadelphia	$29.3	63	401
Lee Hecht Harrison[1] New York City	$15.5	12	75
Challenger Gray & Christmas Chicago	$15.0	17	16
King Chapman Broussard & Gallagher[1] Houston	$10.0	11	45
Murray Axmith & Associates Toronto	$9.0	15	55
Jannotta Bray & Associates Chicago	$9.0	6	30
Mainstream Access[2] New York City	$8.3	11	35
Stevenson Kellogg Ernst & Whitney Toronto	$7.7	13	40
Manchester Philadelphia	$7.5	8	36

[1] Including acquisitions since late 1988. [2] Under Chapter 11 protection.

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move permits the Pilders to break their leases and focus again on group work from more modest digs. Other companies are likely to disappear. Louis Masterson estimates that in Cleveland alone, half the 25 outplacement companies that have sprung up will have to find other things to do within a year.

MERGERS are also shaking the industry. The fifth-ranking firm, King Chapman Broussard & Gallagher, itself the fruit of a merger of New York and Houston companies last year, recently acquired two more firms. Third-ranking Lee Hecht Harrison of New York has bought four companies in less than a year, increasing its offices from four to 12. Eighteen companies, many of them small shops, have banded together in an alliance called Outplacement International.

Outplacement firms won't need huge corporate cutbacks to keep on growing. Companies will be adjusting their work forces constantly. Says AT&T senior vice president Harold Burlingame: "This is a dynamic process. We'll never be the right size. We may be growing in one market but shrinking in another."

Some employers are creating their own outplacement services. Westinghouse has made it a policy since 1982 to offer outplacement help to every employee "involuntarily made available," as the company puts it. That normally will mean several hundred people a year. More than 90% of them will be handled by the company's in-house service. National firms take care of the remainder, the most senior. When GE announced the closing of its Trumbull Lamp Plant in Warren, Ohio, in May 1988, it hired a full-time counselor to help with the plant's 299 workers. Anne Schuler, an approachable, sympathetic mother of 13, had already done the job during two other GE plant closings and will remain at Trumbull at least until next January.

At its best, outplacement has humanized one of the nastier aspects of business life. Rarely nowadays are employees thrown out on the street without help. Outplacement counselors are often called in well before the cutbacks to plan the assistance the employees will need, and they remain available for a long time for people who have trouble landing on their feet. Of course there will likely be no one to assist the outplacement executives who are losing their jobs just now. But then, they should know how to handle it.